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THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE JUNE 2003

OVERVIEW

- In the first quarter of 2003 real gross domestic product (GDP) increased at an annual rate of 2.4%. This reflected a solid increase in domestic demand, while real exports declined 5.7% and real imports increased 2.6%.
- Led by growth in consumer spending and increased residential investment, final domestic demand rose more solidly in the first than in the fourth quarter.
- Export prices rose while import prices fell. Thus, despite a reduced volume of exports and increased imports, the trade surplus rose, contributing to a $12.7-billion widening in the current account surplus to $32.2 billion.
- The Canadian economy created nearly 600,000 net new jobs from the end of 2001 to May 2003. Employment dipped in April and May, and the unemployment rate in May was 7.8%, up from 7.3% in March but down from its recent peak of 8.0% in December 2001.

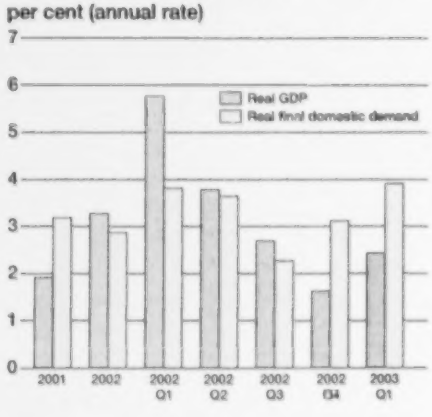
Domestic demand drives growth

Real GDP grew 2.4% in the first quarter compared with a 1.6% rise in the fourth quarter of 2002. Domestic demand led the gain (Chart 1).

Consumer spending is solid

Real consumer expenditure growth remained solid, increasing 3.5% in the first quarter compared with 4.4% in the fourth. Spending on semi-durables, non-durables and services registered solid gains. A decline in motor vehicle sales lowered outlays on durables, despite the continued strong housing market adding further impetus to spending on furniture and appliances.

Chart 1
Growth in real GDP and real final domestic demand



Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, June 6, 2003.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	2001	2002	2002:Q3	2002:Q4	2003:Q1	Most recent	
Real gross domestic product	1.9	3.3	2.7	1.6	2.4		–
Final domestic demand	3.2	2.9	2.3	3.1	3.9		–
Government expenditure							–
Goods and services	3.7	3.0	4.2	2.4	4.0		–
Gross fixed capital	10.3	11.8	5.6	-0.2	5.2		–
Consumer expenditure	2.6	3.4	1.3	4.4	3.5		–
Residential investment	10.3	14.2	15.2	11.1	12.7		–
Business fixed investment	1.0	-6.0	-2.8	-5.0	1.1		–
Non-residential construction	2.2	-10.4	-5.4	-6.5	-0.9		–
Machinery and equipment	0.3	-3.2	-1.3	-4.1	2.2		–
Business inventory investment ($ billion)	-2.1	5.9	8.0	11.6	18.3		–
Exports	-3.1	-0.1	8.5	-8.7	-5.7		–
Imports	-5.0	0.6	5.8	-1.4	2.6		–
Current account balance							
(nominal $ billion)	26.9	23.4	21.3	19.5	32.2		–
(percentage of GDP)	2.4	2.0	1.8	1.6	2.7		–
Nominal personal income	4.0	3.3	3.2	4.2	4.0		–
Nominal personal disposable income	4.4	4.7	2.0	3.7	3.9		–
Real personal disposable income	2.6	2.7	-1.6	1.9	1.1		–
Profits before taxes	-6.0	4.3	19.4	6.1	34.0		–
Costs and prices (%, y/y)							
GDP price deflator	1.1	0.9	1.6	4.1	5.2		–
Consumer price index	2.6	2.2	2.3	3.8	4.5	3.0	Apr-2003
CPI excluding eight most volatile items	2.0	2.4	2.4	2.8	3.1	2.1	Apr-2003
Unit labour costs	2.6	1.5	1.1	2.2	2.1		
Wage settlements (total)	3.2	2.8	2.8	3.3	2.8	2.9	Mar-2003
Labour market							
Unemployment rate (%)	7.2	7.7	7.6	7.6	7.4	7.8	May-2003
Employment growth	1.1	2.2	3.5	3.2	2.2	-1.0	May-2003
Financial markets (average)							
Exchange rate (cents U.S.)	64.6	63.7	64.0	63.7	66.3	74.39	05-Jun-03
Prime interest rate (%)	5.8	4.2	4.5	4.5	4.6	5.00	05-Jun-03

Note: Real values are in chained 1997 dollars.
Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

Personal income increased a healthy 4.0% in the quarter, as employment gains boosted earned income. Real personal disposable income increased about 1% while real personal disposable income per capita stood more than 13% above its most recent low in the second quarter of 1996.

The personal savings rate fell from 3.2% in the fourth quarter to 2.6% in the first.

Residential investment continues to be strong

Low interest rates continued to support the housing market. Residential investment increased 12.7% in the first quarter, the third consecutive double-digit increase. Housing starts rose solidly, contributing to a 10.5% increase in new construction. Spending on renovations and house resales both showed strong growth.

Business fixed investment shows signs of recovery

Business spending on plant and equipment increased 1.1% in the first quarter, following declines in the two previous quarters. Investment in machinery and equipment rose 2.2% despite drops in business spending on telecommunications and transportation equipment. Expenditures on agricultural and other machinery and on computers and software rose.

Non-residential construction decreased for the seventh consecutive quarter, reflecting reduced spending on building construction.

Businesses add to inventories

Businesses boosted inventories $18.3 billion in the first quarter, up from the $11.6-billion inventory investment in the fourth. While the recent accumulation has raised the inventory-to-sales ratio, it remains well within the range of the past five years.

Exports subtract from growth

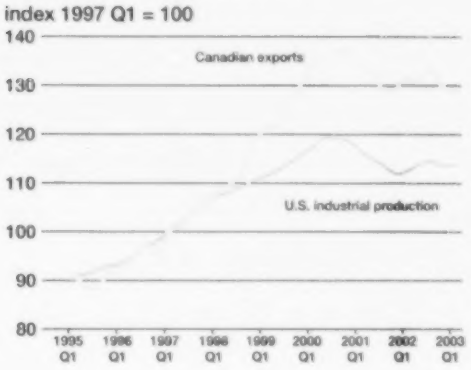
Real exports subtracted from growth, dropping 5.7%. The weakness, largely in industrial products, trucks and machinery and equipment, reflected weak growth in the United States (Chart 2). Canadian service exports also declined, as spending on travel in Canada weakened. Exports of cars and automotive parts rose.

Real imports rose along with domestic demand, increasing 2.6%. Gains were most noticeable in industrial and automotive products and consumer goods. Imports of trucks and automotive parts jumped while those of cars fell.

Current account surplus widens

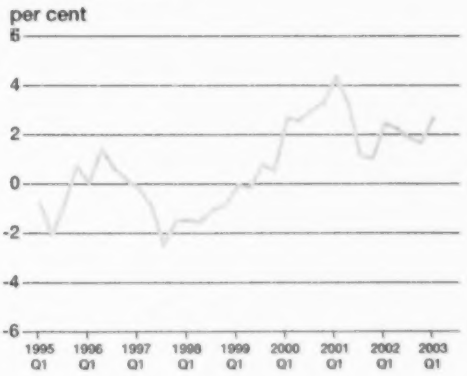
The current account surplus increased $12.7 billion to $32.2 billion, or 2.7% of GDP (Chart 3). Rising export prices, especially for energy products and particularly natural gas, and falling import prices improved the terms of trade and more than offset the negative impact of the decline

Chart 2
Canadian real goods exports and U.S. industrial production



in real exports and the increase in real imports. A sharp drop in dividends paid to non-residents and reduced interest costs for U.S. dollar denominated bonds due to the strengthening Canadian dollar also pushed up the current account surplus. This marks the 15th consecutive quarterly surplus, a sharp contrast to the deficits registered over most of the 1980s and 1990s.

Chart 3
Current account as a percentage of nominal GDP



GDP inflation rises with energy prices

The GDP deflator, a comprehensive measure of inflation, rose 7.5% in the first quarter to stand 5.2% above its level a year earlier. The first-quarter rise was driven by rising prices for exported energy products. The pace of growth in the consumption deflator was a more moderate 2.9% quarter over quarter.

Year-over-year consumer price inflation dropped to 3.0% in April from over 4% in the previous three months, as gasoline and electricity prices fell. Core CPI inflation, which excludes the eight most volatile items, was 2.1%, near the mid-point of the target band of 1% to 3%.

Corporate profits climb to record level

Corporate profits increased 34.0% in the first quarter, following a more modest rise of 6.1% in the fourth. This double-digit gain raised profits' share of GDP to 12.5%, well above the historical average of 10.0%. Profits for the oil and gas industry drove the gain, boosted by higher prices. Wholesalers also recorded strong gains, including those dealing with petroleum products.

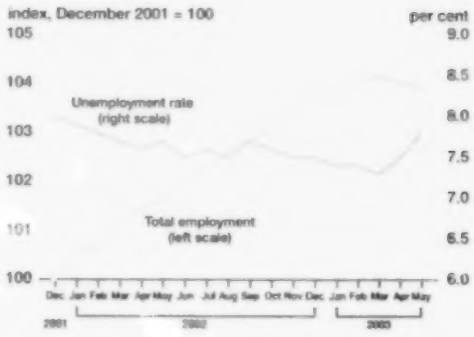
Hourly labour productivity declined in the quarter as hours worked outgrew output. Growth in labour costs per unit of output slowed to 0.9% from 5.1% in the fourth quarter to stand 2.1% higher than a year earlier.

Employment gains continue in Q1

Employment rose 2.2% in the first quarter. The entire gain was in full-time work.

Despite dips in employment in April and May as weak U.S. growth, the war in Iraq and SARS all took their toll, the economy added nearly 600,000 net new jobs from the end of 2001 to May 2003. This strong job creation induced over 600,000 people to enter the labour force since December 2001. The participation rate in May stood at 67.5%,

Chart 4
Employment and the unemployment rate



equal to its record high level, while the unemployment rate was 7.8% compared to 8.0% in December 2001 (Chart 4).

Bank of Canada leaves rates unchanged

On June 3 the Bank of Canada left its key policy rate unchanged, as it now believes that "both core and total CPI inflation will return to the 2 per cent target somewhat earlier than the Bank expected in April." This decision followed 25-basis-point increases in the Bank's target rate in both March and April, which had raised the cumulative increase since early 2002 to 125 basis points.

Canadian short-term rates have increased modestly during 2003 while those in the United States have dipped, widening the spread between Canadian and U.S. short-term rates. Long-term rate differentials have also risen, as long-term rates have declined more in the United States than in Canada.

The value of the Canadian dollar has increased relative to the U.S. dollar so far in 2003. It closed at 74.39 cents U.S. on June 5, its highest value in over six years.

The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Distribution Centre at (613) 995-2855. For other inquiries about this publication, contact Mostafa Askari at (613) 992-3055.
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